

STATE OF MICHIGAN
IN THE SUPREME COURT

Appeal from the Court of Appeals
(Kelly, PJ, and Sawyer and Wilder, JJ)

INTERNATIONAL HOME FOODS, INC.,

Plaintiff-Appellee,

v

DEPARTMENT OF TREASURY

Defendant-Appellant.

Supreme Court No. 130542

Court of Appeals No. 253748

Court of Claims

Case No. 02-000081-MT

Hon. Thomas L. Brown

LENOX, INC.,

Plaintiff-Appellee,

v

DEPARTMENT OF TREASURY,

Defendant-Appellant.

Supreme Court No. 130543

Court of Appeals No. 253760

Court of Claims

Case No. 02-018141-MT

Hon. Thomas L. Brown

DEFENDANT-APPELLANT'S BRIEF ON APPEAL

ORAL ARGUMENT REQUESTED

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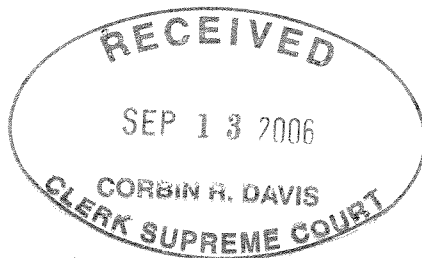


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QUESTION PRESENTED FOR REVIEW

- I. After the Court of Appeals enunciated the appropriate nexus standard necessary to impose the single business tax on business entities, may the Michigan Department of Treasury apply that *court-mandated* nexus standard retrospectively to open tax years (i.e., tax years for which refunds or assessments are not time-barred), notwithstanding previously-published interpretations of the standard issued by the Department?**

Plaintiff-Appellee answers “No.”

Defendant-Appellant answers “Yes.”

The Trial Court answered “Yes.”

The Court of Appeals majority answered “No.”

The Court of Appeals dissent answered “Yes.”

STATEMENT OF APPELLATE JURISDICTION

The Court of Appeals majority issued its decision in this matter on October 4, 2005.¹ In an amended order issued by the Court on January 10, 2006, the Department of Treasury's (the Department's) motion for reconsideration was denied. (87a.) On July 19, 2006, this Court granted the Department's application for leave to appeal. (88a.) Under MCR 7.301(A)(2), this Court maintains jurisdiction to decide the present matter.

¹ *International Home Foods, Inc. v Dep't of Treasury*, 268 Mich App 356; 708 NW2d 711 (2005).

STATEMENT OF PROCEEDINGS AND FACTS

A. Substantive background

This matter involves two separate taxpayers. The first, International Home Foods, Inc., manufactures and sells prepared food products. (42a, ¶ 19.) The company employed approximately ten Michigan residents during the tax years in issue (1989 through 1996); the employees' business activity in this State was to solicit sales for International Home Foods's products. (42a, ¶¶ 22, 23.) The Department conducted a single business tax (SBT) field audit of International Home Foods for the period January 1, 1989 through October 31, 1996. (40a, ¶ 3.) The company neither filed SBT returns nor paid SBT for the 1989 through 1992 tax years within the appropriate time periods. While International Home Foods did file SBT returns for tax years 1993 through 1996, it refused to provide documents for 1989 through 1992 because the company did not believe it was subject to SBT for those years. (15a; 18a.) The Department's auditor determined the company was subject to SBT for the tax years in issue due to its Michigan sales force and business activity. (16a.)

The Department issued an assessment against International Home Foods for SBT in the amount of \$529,396.00, a penalty in the amount of \$264,698.00, plus statutory interest, for tax years 1989 through 1992. (41a, ¶ 8.) A second assessment was issued against the company for tax years 1993 through 1996 for SBT in the amount of \$13,840.00, plus statutory interest. (40a, ¶ 7.) The company appealed the assessments and an informal conference was held in July 2000; the referee's recommendation was to finalize the SBT and statutory interest, but waive the penalty. (41a, ¶¶ 10, 12.) The recommendation was accepted by Revenue Commissioner June Summers Haas in December 2001 and final assessments were issued. (41a, ¶ 13.)

The second taxpayer, Lenox, Inc., is a New Jersey corporation; the company produces fine china and luggage. (38a, ¶ 15.) Lenox employed two sales representatives to conduct business activities in Michigan. (38a, ¶ 19.) Lenox neither filed SBT returns nor paid SBT within the applicable time period for its fiscal year ending April 20, 1990. (37a, ¶ 4.) As a result, the Department assessed Lenox for SBT in the amount of \$37,831.00, plus statutory interest. (37a, ¶ 5.) The company appealed the assessments and an informal conference was held in October 2000; the referee's recommendation was to finalize the SBT with statutory interest. (37a, ¶¶ 6, 7.)

B. Procedural background

International Home Foods and Lenox separately appealed the Department's assessments in the Court of Claims. Regarding International Home Foods, the Court granted the Department's motion for summary disposition, determining that the business activities of the company's resident employees created substantial nexus with the State sufficient to withstand a Commerce Clause challenge. The Court further determined that the nexus standard, expressed in *Gillette v Dep't of Treasury*, and clarified in *MagneTek Controls v Dep't of Treasury*, could be applied retrospectively to the tax years in issue.² (53a-54a.)

Regarding Lenox, the Court of Claims initially granted summary disposition to the Department regarding Count I (which alleged that the Department was legally bound to follow a previously-announced nexus standard), Count III (which alleged that the Department's assessment of SBT violated the fair and just clause of the Michigan Constitution), and Count V (which alleged that the Department was estopped from retrospectively changing the SBT nexus

² *Gillette v Dep't of Treasury*, 198 Mich App 303; 497 NW2d 595 (1993); *lv den* 445 Mich 861; cert den 513 US 1103; 115 S Ct 779; 130 L Ed 2d 673 (1995); *MagneTek Controls v Dep't of Treasury*, 221 Mich App 400; 562 NW2d 219 (1997).

standard) of the complaint. (47a-48a.) The Court based its decision on *Gillette, Syntex v Dep't of Treasury*, (finding that the *Gillette* SBT nexus standard may be applied retrospectively), and *Topps Company v Dep't of Treasury*, (applying *Syntex* for the rule that retrospective application of *Gillette* was proper).³

Subsequently, the Court of Claims disposed of *Lenox* by granting the Department's motion for summary disposition regarding Count II (which alleged that the Department violated *Lenox's* due process rights), and Count IV (which alleged that the Department violated the Commerce Clause of the United States Constitution) of the complaint. Applying *ACCO Brands, Inc v Dep't of Treasury*, the Court determined that the business activities of *Lenox's* two resident sales employees created substantial nexus with the State sufficient to withstand a Commerce Clause challenge.⁴ The Court further determined that the nexus standard, expressed in *Gillette* and clarified in *MagneTek*, could be applied retrospectively to the tax years in issue. (51a-52a.)

International Home Foods and *Lenox* appealed the respective Court of Claims decisions to the Court of Appeals, where the cases were consolidated. There, a majority of the panel determined that the dispositive issue was whether the Department was precluded from retrospectively applying the *Gillette* nexus standard "because of [the Department's] previously-published rulings."⁵ Relying solely on *In re D'Amico Estate*, the majority held the Department was, by virtue of its previously-published interpretations, precluded from retrospectively

³ *Syntex v Dep't of Treasury*, 233 Mich App 286; 590 NW2d 612 (1998), *lv den* 461 Mich 951 (2000); *Topps Company, Inc v Dep't of Treasury*, unpublished opinion per curiam of the Court of Appeals, decided June 11, 1999 (Docket No. 203495).

⁴ *ACCO Brands, Inc. v Dep't of Treasury*, unpublished opinion per curiam of the Court of Appeals, decided November 20, 2003 (Docket No. 242430).

⁵ *International Home Foods*, 268 Mich App at 360, relying on *In re D'Amico Estate*, 435 Mich 551; 460 NW2d 198 (1990).

applying a court-mandated nexus standard.⁶ The majority refused to adhere to and apply the previously-published cases of *Syntex*, *Rayovac Corp v Dep't of Treasury*, or *J W Hobbs v Dep't of Treasury* (a published opinion issued just one month earlier), stating these cases did not “specifically consider” the effect of *D'Amico*.⁷

The Court of Appeals dissent stated that *Rayovac* and *J W Hobbs* directly addressed the majority's dispositive issue.⁸ The dissent further opined that *D'Amico* was clearly distinguishable because in that case the Department first changed its position, which was later endorsed by the courts.⁹

The Department subsequently sought leave to appeal from the January 10, 2006, amended order of the Court of Appeals denying the agency's motion for reconsideration of the Court's majority opinion dated October 4, 2005. (87a.) On July 19, 2006, this Court issued an order granting the Department's application for leave to appeal. (88a.)

C. Historical background

The Single Business Tax Act (SBTA), MCL 208.1 *et seq.*, levies a value-added tax on any person with business activity with the State of Michigan.¹⁰ A value-added tax measures a business entity's total business activity. In calculating the amount of SBT owed to the State, the taxpayer must first determine its total tax base. The taxpayer with business activities that are taxable both in Michigan and in other states must apportion its tax base.¹¹

⁶ *International Home Foods*, 268 Mich App at 362.

⁷ *Rayovac Corp v Dep't of Treasury*, 264 Mich App 441; 691 NW2d 57 (2004); *J W Hobbs v Dep't of Treasury*, 268 Mich App 38; 706 NW2d 460 (2005).

⁸ *International Home Foods*, 268 Mich App at 365-367.

⁹ *International Home Foods*, 268 Mich App at 367.

¹⁰ *Trinova Corp v Dep't of Treasury*, 498 US 358; 111 S Ct 818; 112 L Ed 2d 884, 900 (1991).

¹¹ MCL 208.41.

In 1980, the Department issued Single Business Tax Bulletin 1980-1; this bulletin applied the nexus standard of PL 86-272 for the imposition of Michigan SBT. (2a-3a.) Congress previously enacted PL 86-272 in response to certain decisions of the U.S. Supreme Court regarding the Due Process/Commerce Clause constitutional (“physical presence”) nexus standards.¹² PL 86-272 created an “additional” requirement that a state’s taxation could not be based solely on a foreign business’s solicitation of sales within that state. (In other words, “physical presence” plus something more than the mere solicitation of sales.)

Immediately after the Department’s release of Single Business Tax Bulletin 1980-1, its position was criticized by both accountants and the tax bar. Some of these professionals and their clients argued that PL 86-272 should not apply to the SBT because the SBT was not an income tax.¹³ In 1989, the Department issued Revenue Administrative Bulletin (RAB) 1989-46 stating that the agency would continue to follow the nexus standard of PL 86-272 for purposes of establishing a business entity’s SBT liability. (4a-7a.)

A conflict arose at the trial level (Michigan Court of Claims and Michigan Tax Tribunal) regarding which nexus standard was appropriate: the lower threshold Due Process/Commerce Clause (“physical presence” standard) or the higher threshold standard of PL 86-272 (“physical presence” plus). Taxpayers argued both sides because how they were affected depended on which nexus standard was applied. Michigan businesses with sales to other states tended to support the Due Process/Commerce Clause nexus standard, while out-of-state businesses selling to Michigan customers favored the higher standard of PL 86-272. Indeed, the cases of *Gillette*

¹² See *Quill Corp v North Dakota*, 504 US 298, 316 n 19; 112 S Ct 1904; 119 L Ed 2d 91 (1992).

¹³ PL 86-272 only addressed the imposition of a state’s *income* tax.

and *Guardian Industries v Dep't of Treasury* illustrate the nexus standard debate.¹⁴ Gillette, an out-of-state company with an in-state sales force of eighteen persons, sought the protection of the higher nexus standard imposed by PL 86-272. Guardian, a Michigan company seeking to exclude its out-of-state sales from its Michigan SBT computation, argued that PL 86-272 did not apply at all to the SBTA.

In deciding *Gillette* and *Guardian* in 1993, the Court finally resolved the question of which nexus standard was applicable to Michigan's imposition of SBT; according to the Court, the Department had been and was erroneously applying the nexus standard of PL 86-272. The Court made it clear that the Due Process/Commerce Clause ("physical presence") nexus standard established the minimum level of conduct a taxpayer must undertake in this State before it may become liable for SBT.

The Court later explained the level of physical presence necessary to establish sufficient nexus under the Due Process/Commerce Clause standard. In *MagneTek*, the Court held that the temporary presence of employee sales representatives in Michigan for approximately ten days per year and the presence of a non-exclusive independent sales representative in the State satisfied the Due Process/Commerce Clause nexus standard.¹⁵ Here, there is no question that International Home Foods and Lenox's resident employees exceeded the level of physical presence stated in *MagneTek*.

In response to the Court's opinion in *Gillette*, and recognizing that it had been applying a nexus standard the courts deemed incorrect, the Department notified thousands of nonfiling, potential SBT taxpayers in November 1993 that they would no longer be able to use PL 86-272

¹⁴ *Gillette*, 198 Mich App at 303; *Guardian Industries v Dep't of Treasury*, 198 Mich App 363; 499 NW2d 349 (1993), *lv den* 444 Mich 943 (1994).

¹⁵ *MagneTek*, 221 Mich App at 400.

as a shield against SBT liability. The Department's action extended to these nonfiling business entities the opportunity to remit SBT owed with interest, but without the assessment of penalties, for tax years beginning in 1989.¹⁶

The Court of Appeals subsequently rejected several challenges brought by taxpayers to the Department's retrospective application of the Due Process/Commerce Clause nexus standard enunciated in *Gillette* and clarified in *MagneTek*.

¹⁶ Although the opinion in *Gillette* was not issued until 1993, the Court nevertheless upheld the Department's assessments for the tax years at issue in that case, 1976 through 1981. Thus, the Department determined that it would retrospectively apply the Due Process/Commerce Clause nexus standard to tax years still open at the time of the *Gillette* decision.

ARGUMENT

- I. After the Court of Appeals enunciated the appropriate nexus standard necessary to impose the single business tax on business entities, the Michigan Department of Treasury may apply that *court-mandated* nexus standard retrospectively to open tax years (i.e., tax years for which refunds or assessments are not time-barred), notwithstanding previously-published interpretations of the standard issued by the Department.**

A. Standard of review

This Court reviews questions of law de novo.¹⁷ This is the same standard of review applicable to the grant of a motion for summary disposition.¹⁸

B. Preservation of issue

This issue was directly addressed by the Court of Claims and the Court of Appeals in both cases.

C. Analysis

- 1. The appropriate nexus standard in this matter is that announced by the Michigan Court of Appeals in *Gillette* and clarified in *MagneTek*.**

International Home Foods and Lenox's assertions to the contrary, there is only one nexus standard that must be met before the Department may seek to impose SBT on a business entity.

In 1993, the Court issued its opinion in *Gillette*.¹⁹ Until that decision, the Department erroneously considered the more stringent federal statutory provision found in PL 86-272 as the nexus standard governing the SBTA.²⁰ The effect of the Court's ruling in *Gillette* was to

¹⁷ *General Motors Corp v Dep't of Treasury*, 466 Mich 231, 236; 644 NW2d 734 (2002).

¹⁸ *General Motors*, 466 Mich at 236.

¹⁹ *Gillette*, 198 Mich App 303.

²⁰ *Gillette*, 198 Mich App at 307-308, 311.

invalidate the Department's prior bulletins advising taxpayers that PL 86-272 was applicable.²¹

Gillette thus resolved the question of which standard set the minimum contacts a foreign business must have with Michigan to be lawfully subject to the SBT. The Court determined these contacts need only satisfy the Due Process and Commerce Clauses of the U.S.

Constitution. *Sua sponte*, the Court held "that the restriction imposed by PL 86-272 does not apply to taxes imposed under the [SBT]."²² The court then turned to the task of determining whether "imposition of the [SBT] on [Gillette] is permissible under the Due Process and Commerce Clauses, U.S. const, Am XIV and art I, § 8, cl 3."²³

Analyzing the Due Process Clause requirements for state taxation, the Court stated²⁴:

In order to meet the requirements of the Due Process Clause there must be "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Quill Corp v North Dakota*, 504 US 298; 112 S Ct 1904, 1909; 119 L Ed 2d 91, 102 (1992), quoting *Miller Bros Co v Maryland*, 347 US 340, 344-345; 74 S Ct 535; 98 L Ed 744 (1954). Additionally, the income attributed for tax purposes must be rationally related to "values connected with the taxing State." *Id.*, quoting *Moorman Mfg Co v Bair*, 437 U.S. 267, 273; 98 S Ct 2340; 57 L Ed 2d 197 (1978).

Regarding whether *Gillette* was subject to SBT under the Due Process Clause, the Court found²⁵:

[P]etitioner purposefully directed its activities at Michigan residents and the magnitude of its contacts is "more than sufficient for due process purposes." Furthermore, the [SBT] is related to the benefits petitioner receives from access to Michigan.

²¹ PL 86-272 prohibited states from exercising their income tax jurisdiction over a taxpayer whose activities in the taxing state were confined to the solicitation of sales. The Department's bulletins 1980-1 and 1989-46 advised taxpayers PL 86-272's solicitation of sales "safe harbor" applied to Michigan's Single Business Tax Act (SBTA), MCL 208.1 *et seq.*

²² *Gillette*, 198 Mich App 311.

²³ *Gillette* 198 Mich App at 311.

²⁴ *Gillette*, 198 Mich App at 311-312.

²⁵ *Gillette*, 198 Mich App at 313.

The Court next examined the *Complete Auto Transit, Inc v Brady* four-prong test used to determine whether a state tax is valid under the Commerce Clause²⁶:

- (1) the activity taxed must have a substantial nexus to the taxing State,
- (2) the tax must be fairly apportioned,
- (3) it may not discriminate against interstate commerce, and
- (4) it must be fairly related to services the state provides.

Addressing the first prong – nexus – (the primary issue in *Gillette* and in the present matter), the Court applied the U.S. Supreme Court’s decision in *Quill* to determine whether a foreign business was subject to the SBT. The Court in *Gillette* stated²⁷:

In *Quill*, the Court was concerned with whether a taxpayer must have a physical presence in the taxing state before a substantial nexus could be established. In reaffirming the physical presence requirement of *Nat’l Bellas Hess, Inc v Illinois Dep’t of Revenue*, 386 US 753; 87 S Ct 1389; 18 L Ed 2d 505 (1967), the Court noted that the presence in a state of a small sales force, plant, or office may be sufficient to establish a substantial nexus for Commerce Clause purposes.

The Court explained that *Quill* reaffirmed the requirement that a taxpayer must have a physical presence in a taxing State to establish substantial nexus under the Commerce Clause.²⁸

The *Gillette* decision established the Due Process/Commerce Clause nexus standard as *the* nexus standard governing the SBTA.²⁹

The Court then turned to the taxpayer’s *separate* claim that the company did not engage in “business activity” within Michigan. The Court noted SBT is imposed on every person with

²⁶ *Complete Auto Transit, Inc v Brady*, 430 US 274, 279; 97 S Ct 1076; 51 L Ed 2d 326 (1977); *Gillette*, 198 Mich App at 313.

²⁷ *Gillette*, 198 Mich App at 313-314.

²⁸ *Gillette*, 198 Mich App at 313.

²⁹ The Court held the taxpayer's Michigan sales force rendered it susceptible to single business tax (SBT) under *Quill*'s Due Process/Commerce Clause analysis. *Gillette*, 198 Mich App at 314.

business activity in Michigan.³⁰ The Court found that the taxpayer's solicitation of sales constituted "business activity"³¹:

During the period in question, petitioner engaged in business activity in Michigan through its sales representatives, who personally approached Michigan businesses and solicited orders for petitioner's products, provided expertise and advice to those businesses regarding the sale of petitioner's products to their customers, and acted as liaison between those businesses and petitioner. These are essentially the same activities performed by the taxpayer in *Trinova*^[32] where the Court, noting the definition of business activity provided in MCL 208.3 . . . found that Trinova's sales to Michigan customers were a "business activity." [Citation omitted.]

Petitioner argues that the transfer of legal title to the property sold did not occur in this state. However, we note that petitioner's sales representatives, while soliciting orders, were also engaged in performing services for its customers "with the object of gain, benefit, or advantage, whether direct or indirect."

The Court determined that SBT could be imposed on the taxpayer because it conducted "business activity" in Michigan. However, this determination came *after* sufficient nexus was found by the Court.

As a result of the Court's ruling in *Gillette*, the Department then believed the Due Process/Commerce Clause nexus standard required a resident employee of the foreign business in Michigan, and informed taxpayers of this belief. Subsequently, however, the Court of Appeals in *MagneTek* clarified the *level* of physical presence necessary to establish substantial nexus under the Due Process/Commerce Clause nexus standard.³³

In *MagneTek*, the Department appealed the Court of Claims decision holding that the presence of non-resident employees *could* establish nexus.³⁴ The Court found that the presence

³⁰ MCL 208.31; *Gillette*, 198 Mich App at 314-315.

³¹ *Gillette*, 198 Mich App at 315.

³² *Trinova*, 433 Mich 141.

³³ *MagneTek*, 221 Mich App at 409-412.

³⁴ *MagneTek*, 221 Mich App at 405.

of MagneTek's employees in a State for ten business days annually was sufficient.³⁵ The Court of Appeals affirmed, finding MagneTek had nexus with States where its employees conducted economic activities on its behalf.³⁶ In reaching its decision, the Court relied on the application of *Quill* by New York's highest court in *In re Orvis Co, Inc.*³⁷ The Court of Appeals relied on *Orvis* because the facts in that case were closer to the facts at hand than those in *Gillette*.³⁸

Our Court has previously considered the application of *Quill* in *Guardian Industries Corp v Dep't of Treasury*, 198 Mi App 363; 499 NW2d 349 (1993), and *Gillette Co v Dep't of Treasury*, 198 Mich App 303; 497 NW2d 595 (1993), but neither precedent is helpful for the question at issue here. In *Gillette, supra* at 314, the Court found that the physical presence requirement was satisfied where a taxpayer had a level of activity far in excess of that at issue here, the employment of at least eighteen full-time sales representatives soliciting orders from customers in the target state as well as an ownership interest in various properties there.

* * *

Of the many precedents cited by both parties from other jurisdictions applying *Quill*, we find *In re Orvis Co, Inc v Tax Appeals Tribunal of the State of New York*, 86 NY2d 165; 654 NE2d 954, 630 NYS2d 680 (1995), most instructive. After a complete review of *Quill* in the context of *Bellas Hess* and other Supreme Court precedents, the court in *Orvis* rejected the taxpayer's claim that *Quill* increased the in-state physical presence requirement of the substantial nexus analysis to require "substantial amounts of in-State people or property." [Citation omitted.]

The court went on to explain the minimum physical presence required to establish nexus³⁹:

[R]equiring that physical presence be substantial would "destroy" the bright line rule the Supreme Court in *Quill* thought it was preserving; it would require "weighing of factors such as number of local visits, size of local sales force, intensity of direct solicitations, etc." to determine whether there was "substantial" physical presence in the target state. [Citation omitted.]

³⁵ *MagneTek*, 221 Mich App at 405.

³⁶ *MagneTek*, 221 Mich App at 411, 412.

³⁷ *In re Orvis Co, Inc. v Tax Appeals Tribunal of the State of New York*, 86 NY2d 165; 654 NE2d 954 (1995).

³⁸ *MagneTek*, 221 Mich App at 409-410.

³⁹ *MagneTek*, 221 Mich App at 410-411.

Finally, the Court in *Orvis* [. . .] noted that in a recent case, *Oklahoma Tax Comm v Jefferson and Lines, Inc*, 514 U.S. 175; 115 S. Ct. 1331; 131 L. Ed. 2d 261 (1995), the Supreme Court “did *not* apply substantial physical presence tests, but instead strictly utilized the substantial nexus prong of the *Complete Auto* test without even passing reference to the substantiality of the physical presence of the vendor . . . in the taxing State.”

On the basis of this survey of relevant precedents, the court in *Orvis* [. . .] determined that *Quill* required the following test:

While a physical presence . . . is required, it need not be substantial. Rather, it must be demonstrably more than a "slightest presence." . . . And it may be manifested by the presence in the taxing State of . . . property or the conduct of economic activities in the taxing State performed by the vendor's personnel or on its behalf. [Emphasis in the original.]

Regarding the taxpayer's Michigan presence, the Court in *MagneTek* held the temporary presence of a taxpayer's employees for approximately 10 days per year and the presence of a nonexclusive independent sales representative in the taxing state was sufficient physical presence to establish substantial nexus⁴⁰:

In contrast to *Gillette*, the present case does not involve a full-time sales staff at work in the target states; in contrast to *Guardian*, there is no argument here that plaintiff did not have the level of physical presence determined by the trial court in the target states for each of the tax years for which relief was granted, i.e., at least two weeks' work of solid sales effort by plaintiff's employees and a continuous presence of independent sales persons representing plaintiff's lines among those of other companies.

The Court agreed with *MagneTek*, holding nexus could be established by an independent sales representative⁴¹:

On the basis of our review of *Quill* and surrounding precedents, we conclude that the court in *Orvis* correctly understood *Quill* and enunciated an appropriate test for applying *Quill*. Accordingly, just as *Orvis* rejected the taxpayer's argument that substantial nexus requires “substantial amounts of in-State people or property,” [. . .] we reject defendant's argument that an in-state sales force

⁴⁰ *MagneTek*, 221 Mich App at 409.

⁴¹ *MagneTek*, 221 Mich App at 411-412.

continuously soliciting customers is needed. Instead, tax obligations may be imposed, consistent with the Commerce Clause, on taxpayers with "demonstrably more than a 'slightest presence'" in a state, and this requirement can be satisfied by "the conduct of economic activities in the taxing State performed by the vendor's personnel or on its behalf." [Citations omitted.]

As a result of the Court's ruling in *MagneTek*, the Department was once again required to modify the SBT nexus standard and replaced RAB 1989-46 with RAB 1998-1, which provides in relevant part⁴²:

The U.S. Supreme Court has most recently addressed the Commerce Clause substantial nexus requirement for use tax collection in *Quill*

* * *

The Michigan Court of Appeals in *MagneTek Controls, Inc v Dep't of Treasury*, 221 Mich App 400; 562 NW2d 219 (1997), applied the *Quill* decision and held that the requirement of "substantial nexus" does not mean that physical presence in the taxing state must be substantial but only that it be more than the slightest physical presence. Quoting from *Orvis v Tax Appeals Tribunal of the State of New York*, 86 NY2d 165; 654 NE2d 954, 960-961 (1995), the Michigan Court of Appeals stated the test as follows:

While a physical presence . . . is required, it need not be substantial. Rather, it must be demonstrably more than a "slightest presence". . . . And it may be manifested by the presence in the taxing State of . . . property or the conduct of economic activities in the taxing State performed by the vendor's personnel or on its behalf.

[Citations omitted.]

Though the taxpayer in *MagneTek* had no offices or plants in the other states, the Court of Appeals found that the taxpayer's 10 business days or "two weeks of solid effort" annually in each of the destination states was sufficient. The Court rejected the argument that an in-state sales force continuously soliciting sales had to be present in each of the other states before the taxpayer could meet the "substantial nexus" requirement in those states. It regarded as relevant both the visits and activity of sales managers as well as sales visits by independent sales representatives.

* * *

⁴² RAB 1998-1 may be found in the Department's Appendix, pp 8a-14a.

This RAB reflects the U.S. Supreme Court and the Michigan Court of Appeals decisions discussed above.

Recently, in *Rayovac*, the Court held that the analysis in *MagneTek* was applicable in determining the level of physical presence necessary to establish nexus by an foreign business conducting business activity in Michigan. The Court stated⁴³:

[T]he constitutional question presented in *MagneTek* is identical to the constitutional question here: whether an out-of-state seller has sufficient contacts with another state to satisfy the “substantial nexus” requirement of the Commerce Clause permitting the other state to tax the out-of-state seller.

Again, the Court found the Due Process/Commerce Clause nexus standard to be the only one applicable to the SBTA ⁴⁴:

We reject plaintiff’s argument that the statutory definition of “business activity” creates an additional jurisdictional limit restricting the imposition of the SBT. [Emphasis added.] MCL 208.31(1) imposes “a specific tax upon the adjusted tax base of every person with business activity in this state that is allocated or apportioned to this state” at a specified percentage. See Trinova Corp v Dep’t of Treasury, 433 Mich 141, 149-153; 445 NW2d 428 (1989), and Gillette, supra at 308-310. Pertinent to plaintiff’s argument, MCL 208.3(2) defines “business activity” as:

a transfer of legal or equitable title to or rental of property, whether real, personal, or mixed, tangible or intangible, or the performance of services, or a combination thereof, made or engaged in, or caused to be made or engaged in, within this state, whether in intrastate, interstate, or foreign commerce, with the object of gain, benefit, or advantage, whether direct or indirect, to the taxpayer or to others, but shall not include the services rendered by an employee to his employer. [Emphasis in the original.]

Plaintiff’s argument fails because its Michigan sales representatives were engaged in arranging the transfer of legal or equitable title of property “with the object of gain, benefit, or advantage” to plaintiff. Plaintiff’s personnel within this state conducted “business activity,” creating a substantial nexus for purposes of imposing the SBT. See *Gillette, supra* at 198, citing *Trinova, supra* at 161; see, also, MCL 208.52(a), which provides: “Sales of tangible personal property are in

⁴³ *Rayovac*, 264 Mich App at 446.

⁴⁴ *Rayovac*, 264 Mich App at 446.

this state [if] . . . the property is shipped or delivered to a purchaser, . . . within this state”

As in *MagneTek*, after finding sufficient nexus under the Due Process/Commerce Clause nexus standard, the Court determined Rayovac’s employees conducted business activity in Michigan where “its Michigan sales representatives were engaged in arranging the transfer of legal or equitable title of property ‘with the object of gain, benefit, or advantage’ to plaintiff.”⁴⁵

Again, there exists just one SBT nexus standard: the Due Process/Commerce Clause standard enunciated in *Gillette* and clarified in *MagneTek*.⁴⁶

2. A court-mandated nexus standard may be applied retrospectively to open tax years, notwithstanding previously-published interpretations of the standard issued by the Department.

Retrospective application of a court-mandated nexus standard is well-settled in Michigan. Although the Court of Appeals decision in *Gillette*, applying the Due Process/Commerce Clause nexus standard, was not issued until 1993, the Court *nonetheless upheld the Department’s assessments for the tax years 1976 through 1981* under this standard, *despite* the agency’s previous bulletins applying the higher PL 86-272 standard.

Furthermore, subsequent to the Court’s decision in *MagneTek*, the taxpayer in *Syntex*⁴⁷ sought to cancel an SBT assessment for the years 1982 and 1983, contending the retrospective application of the Due Process/Commerce Clause nexus standard violated its constitutional rights.⁴⁸ The Court explained that judicial decisions are generally applied retrospectively.⁴⁹ The Court held the Department’s application of the Due Process/Commerce Clause test to the

⁴⁵ *Rayovac* 264 Mich App at 447.

⁴⁶ Later applied in *Syntex*, 233 Mich App 286, and *J W Hobbs*, 268 Mich App 38.

⁴⁷ *Syntex*, 233 Mich App 286.

⁴⁸ *Syntex*, 233 Mich App at 289-290.

⁴⁹ *Syntex*, 233 Mich App at 292-293.

taxpayer did not violate the company's constitutional rights to equal protection and due process. According to *Syntex*, the "test to determine whether laws comport with due process is essentially the same as that for equal protection: they must be sustained if rationally related to a legitimate government purpose."⁵⁰ Moreover, the Court found that the Department held a rational basis for its decision to enforce the Due Process/Commerce Clause nexus standard.⁵¹ The Court then explained that while due process may prevent retrospective laws from divesting rights to property or vested rights, such concerns were not present with retrospective application of a revised nexus standard regarding taxation⁵²:

While petitioner may not have expected this Court to reject the PL 86-272 test, the Court's decision is not unexpected and indefensible because the appellate courts of this state had never resolved whether the PL 86-272 test was appropriate for determining single business tax liability In any event, petitioner did not have a vested right in the continuation of any tax law.

Implicit in *Gillette* and in explicit subsequent case law applying *Gillette*, is the determination that a retrospective application of the Due Process/Commerce Clause SBT nexus standard is both constitutional and consistent with Michigan case law.⁵³ Furthermore, the Court in *Rayovac* was quite clear in determining whether the Department may retrospectively apply the Due Process/Commerce Clause nexus standard, notwithstanding the agency's prior publications setting forth an erroneous standard⁵⁴:

⁵⁰ *Syntex*, 233 Mich App at 292.

⁵¹ *Syntex*, 233 Mich App at 292.

⁵² *Syntex*, 233 Mich App at 293.

⁵³ In addition to the published cases of *Syntex* and *Rayovac*, the Court of Appeals issued a number of unpublished decisions holding that the Due Process/Commerce Clause nexus standard can be applied retrospectively: See *ACCO*; *Redken Laboratories v Michigan Dep't of Treasury*, unpublished opinion per curiam of the Court of Appeals decided September 18, 2001 (Docket No. 221439); *Topps*; *Cosmair v Michigan Department of Treasury*, unpublished opinion per curiam of the Court of Appeals decided March 20, 1998 (Docket No. 198240). Copies of these four opinions are attached to the Department's appeal brief.

⁵⁴ *Rayovac*, 264 Mich App 448-449.

We agree with the trial court that the issues plaintiff raised below and on cross appeal do not provide an alternative basis for granting summary disposition in its favor. *The retrospective application of the SBT for the tax years at issue does not discriminate against or unconstitutionally burden interstate commerce.* See *Harper v Virginia Dep't of Taxation*, 509 U.S. 86; 113 S. Ct. 2510; 125 L. Ed. 2d 74 (1993); *Syntex Laboratories v Dep't of Treasury*, 233 Mich. App. 286; 590 N.W.2d 612 (1998). Moreover, defendant is not estopped from retrospectively applying the new rule created by case law *simply because it had issued revenue administrative bulletins advising taxpayers of what the then-applicable rule was.* n1 Contrary to what plaintiff asserts, defendant did not "bait and switch." Cf., *Newsweek, Inc v Florida Dep't of Revenue*, 522 U.S. 442; 118 S. Ct. 904; 139 L. Ed. 2d 888 (1998). In addition, plaintiff has no vested right to continued application of a particular taxing standard, so it cannot claim that imposition of the SBT constitutes unfair and unjust treatment. *Syntex Laboratories, supra* at 293. Finally, defendant was not barred from retrospectively applying the SBT by the doctrine of laches because plaintiff cannot show hardship as a result of the delay. [Citations omitted.] [Emphasis added.]

This is consistent with the U.S. Supreme Court's teaching that judicial decisions must be applied to all open matters, *notwithstanding a party's reliance on a prior rule.*⁵⁵ In *Harper v Virginia Dep't of Taxation*, the State of Virginia argued against retrospective application of the Supreme Court's decision in *Davis v Michigan* requiring equal state tax treatment of federal and state pension benefits.⁵⁶ The Court in *Harper* declared the following⁵⁷:

When this Court applies a rule of federal law to the parties before it, that rule is the controlling interpretation of federal law and must be given full retrospective effect in all cases still open on direct review *and as to all events, regardless of whether such events predate or postdate our announcement of the rule.* . . . [W]e now prohibit the erection of selective temporal barriers to the application of federal law in noncriminal cases. In both civil and criminal cases, we can scarcely permit "the substantive law [to] shift and spring" according to "the particular equities of [individual parties'] claims" of actual reliance on an old rule and of harm from a retrospective application of the new rule. Our approach to

⁵⁵ See also *Hyde v University of Michigan Bd of Regents*, 426 Mich 223, 240; 393 NW2d 847 (1986), citing *Tebo v Havlik*, 418 Mich 350, 360-361; 343 NW2d 181 (1984), the general rule is that judicial decisions are to be given complete retroactive effect. Complete prospective application is generally limited to decisions which overrule clear and uncontradicted *case law*. *Tebo*, 418 Mich at 361-363 n12.

⁵⁶ *Harper v Virginia Dep't of Taxation*, 509 US 86; 113 S Ct 2510; 125 L Ed 2d 74 (1992); *Davis v Michigan*, 489 US 803; 109 S Ct 1500; 103 L Ed 2d 891 (1989).

⁵⁷ *Harper*, 509 US at 97.

retroactivity heeds the admonition that "[t]he Court has no more constitutional authority in civil cases than in criminal cases to disregard current law or to treat similarly situated litigants differently." [Citations omitted]. [Emphasis added.]

The Court of Appeals decision in *Rayovac* should have put to rest the incessant litigation regarding the present issue; unfortunately, it did not. In *J W Hobbs*, the taxpayer once again argued that the Department was precluded from retrospectively applying the Due Process/Commerce Clause nexus standard, where there existed previously-published, though erroneous, agency interpretations of the standard to be applied.⁵⁸ There, the taxpayer asserted that the Department was "bound by its published [nexus standard] interpretations in its RABs."⁵⁹ Once again, a majority of the Court of Appeals panel succinctly rejected this frequently-raised taxpayer argument⁶⁰:

Our Supreme Court has held that RABs are only interpretations of the applicable statutes and do not have the force of law. [Citations omitted.] . . . Thus, [the Department] is not legally bound to adhere to its stated interpretation of tax law in its RABs

The majority in *J W Hobbs* reiterated the Court's prior determination that the Department was not precluded from retrospectively applying a new nexus standard "simply because it had issued revenue administrative bulletins advising taxpayers of what the then-applicable rule was."⁶¹ The stated position of the Court's published opinion could not be more clear.

In the present case, the dissent recognized that clarity: "[T]he retrospective application of *Gillette* has previously been decided by this Court *on the identical issues presented here*."⁶² (Emphasis added.) Almost one month to the day of the published decision in *J W Hobbs*,

⁵⁸ *J W Hobbs*, 268 Mich App 38.

⁵⁹ *J W Hobbs*, 268 Mich App at 45-46.

⁶⁰ *J W Hobbs*, 268 Mich App at 46.

⁶¹ *J W Hobbs*, 268 Mich App at 46, citing *Rayovac*, 264 Mich App at 448-449.

⁶² *International Home Foods*, 268 Mich App at 365.

however, the majority in the present matter refused to recognize well-settled and binding precedent.

3. ***In re D'Amico Estate*, the sole case relied on by the Court of Appeals majority in reversing the Court of Claims in this matter, does not preclude the Michigan Department of Treasury from retrospectively applying a court-mandated nexus standard to open tax years, notwithstanding previously-published interpretations of the standard issued by the Department.**

Here, while acknowledging that *Rayovac v Dep't of Treasury*⁶³ “considered the argument whether [the Department] is bound by . . . earlier revenue rulings,” the Court of Appeals majority simply chose not to apply on-point precedent.⁶⁴ According to the majority, *Rayovac* and apparently other previous cases addressing the same issue were not “dispositive” because they did not “specifically consider” the applicability of *In re D'Amico Estate*.⁶⁵ The Department respectfully submits that the majority committed clear error in making this determination.

D'Amico was decided by this Court approximately three years before the Court of Appeals decision in *Gillette* (permitting the retrospective application of the Due Process/Commerce Clause nexus standard), approximately seven years before the Court of Appeals decision in *MagneTek* (permitting the retrospective application of the Due Process/Commerce Clause nexus standard), approximately eight years before the Court of Appeals decision in *Syntex* (permitting the retrospective application of the Due Process/Commerce Clause nexus standard), approximately fourteen years before the Court of Appeals decision in *Rayovac* (permitting the retrospective application of the Due

⁶³ *Rayovac v Dep't of Treasury*, 264 Mich App 441; 691 NW2d 57 (2004).

⁶⁴ *International Home Foods*, 268 Mich App at 364.

⁶⁵ *International Home Foods*, 268 Mich App at 364, referring to *In re D'Amico Estate*, 435 Mich 551; 460 NW2d 198 (1990).

Process/Commerce Clause nexus standard), and approximately fifteen years before the Court of Appeals decision in *J W Hobbs* (permitting the retrospective application of the Due Process/Commerce Clause nexus standard). In all that time, neither this Court nor the Court of Appeals ever determined *D'Amico* to be a bar to the Department's retrospective application of a *court-mandated* nexus standard, *even when the taxpayer argued the agency should not be allowed to do so because of previously-issued agency bulletins*.

The Court of Appeals refusal to find *D'Amico* applicable to this issue certainly cannot be attributed to its unawareness or ignorance of that case. In *Rayovac*, the taxpayer, citing *D'Amico*, argued that the Department should not be allowed to retrospectively change its previously-stated interpretation regarding the necessary nexus to impose SBT. (70a-76a.) Responding to this argument, the Department asserted that, despite *D'Amico*, it was proper to retrospectively apply the Due Process/Commerce Clause to the taxpayer. (65a-69a.) While not “specifically” citing to *D'Amico*, the Court unequivocally stated⁶⁶:

Moreover, [the Department] is not estopped from retrospectively applying the new rule *created by case law* simply because it had issued revenue administrative bulletins advising what the then-applicable rule was. [Emphasis added.]

There can be no credible argument that the Court of Appeals failed to consider the inapplicability of *D'Amico* when it decided *Rayovac*.⁶⁷

⁶⁶ *Rayovac*, 264 Mich App at 448-449.

⁶⁷ See also *Topps Company, Inc v Dep't of Treasury*, unpublished opinion per curiam of the Court of Appeals, decided June 11, 1999 (Docket No. 203495):

Defendant's reliance on *In re D'Amico Estate* [citation omitted] is misplaced. In *D'Amico*, the Treasury Department first changed its position, and later had its change endorsed by the courts. [Citation omitted.] Thus, the Department changed its position before being required to do so pursuant to a court order. [Citation omitted.] Conversely, in this case, defendant changed its position only after it was forced to do so by an order of this Court. [Citation omitted.]

Likewise, in *J W Hobbs*, the Department asserted that *D'Amico* did not preclude the agency's retrospective application of a court-mandated nexus standard. (83a-86a.) In response, the taxpayer contended that *D'Amico* required such a preclusion. (77a-82a.) Yet again, the Court disagreed with the taxpayer. Quoting the above-noted determination in *Rayovac*, the majority in *J W Hobbs* held that the Department "is not legally bound to adhere to its stated interpretation of tax law in its RABs."⁶⁸ As in *Rayovac*, there can be no credible argument that the majority did not consider *D'Amico* when it correctly decided *J W Hobbs*.

A court should not be required to "specifically consider" (i.e., cite and address within its opinion) each and every case brought to its attention by the parties in reaching a decision. If that were an obligation, the written opinions of the courts of this State will be required to be much longer, containing exhaustive citations or innumerable footnotes so as to not miss a single case, state or federal, that might arguably pertain to the issue in dispute. Because, to leave one out for any reason would create, in and of itself, grounds for appeal or worse, grounds permitting a court to ignore binding precedent.

Furthermore, the case of *D'Amico* is highly distinguishable from the facts of the present matter. First, *D'Amico* did not involve a situation where an initial agency interpretation of a nexus standard was subsequently replaced by a court decision. Rose D'Amico won a state lottery prize entitling her to \$1,000,000 payable in twenty annual installments of \$50,000. She died with fourteen installments unpaid. Following its eleven-year practice of not seeking to tax State-lottery proceeds, the Department did not include the remaining lottery proceeds when it performed its 1981 calculation of inheritance tax. But in 1983, the Department unilaterally decided to seek the collection of inheritance tax on the transfer of the right to receive the future

⁶⁸ *J W Hobbs*, 268 Mich App at 46.

installments of a decedent's lottery winnings. Three years later, the Department, applying its new policy, recalculated the inheritance tax and sought to impose an additional tax on D'Amico's heirs.⁶⁹

After spending considerable time addressing the then-current provision of the State Lottery Statute, the distinction between a "direct" tax and an "indirect" tax, and the distinction between the application of a "direct" tax on property or income and a tax on the privilege of transferring or receiving property, this Court turned to the Department's *unilateral* change in policy⁷⁰:

For over a decade, the department construed . . . the Lottery Act as exempting state lottery prize proceeds from inheritance taxation. Persons who bought lottery tickets during the regime when the department and field examiners were administering the inheritance tax law as exempting lottery proceeds from inheritance tax should be accorded the benefit of the first, contemporaneous construction of the law:

It has been held that an administrative agency having interpretive authority may reverse *its* interpretation of a statute, but that *its* new interpretation applies only prospectively. [Citation omitted.] [Emphasis added.]

It is this portion of *D'Amico* that the Court of Appeals majority in the present matter relied on in choosing to ignore on-point and binding precedent. Here, the Department did not decide to unilaterally change its long-standing policy, based on its interpretation of a statute, in favor of a new agency interpretation and attempt to apply it retrospectively. Like the Court of Appeals dissent in this case, this Court should consider such a significant factual difference essential in reversing the majority's opinion⁷¹:

[T]he majority's reliance on [*D'Amico*] is misplaced. In *D'Amico*, the [Department] changed its position, and later had its change endorsed by the

⁶⁹ *D'Amico*, 435 Mich at 553.

⁷⁰ *D'Amico*, 435 Mich at 562.

⁷¹ *International Home Foods*, 268 Mich App at 367.

courts. [Citation omitted.] In contrast, the [Department] in this case changed its position only after it was forced to do so by the courts. And the general rule is that judicial decisions are to be given complete retrospective effect. [Citation omitted.]

Here, the Department changed its interpretation of a nexus standard, not defined in the SBTA, only as a result of the Court's decision in *Gillette* and further clarified in *MagneTek*. For this reason alone, *D'Amico* does not apply; it simply does not address the retrospective application of a *court-mandated* change in a state agency's prior interpretation or policy. This conclusion is supported by this Court's statement in *D'Amico*⁷²:

There not having been a ruling by this Court establishing the law of Michigan, the department's eleven-year practice of exempting lottery proceeds from inheritance tax . . . takes on, in our opinion, decisive significance. [Emphasis added.]

Here, this Court would have to ignore the intervening court-mandated nexus standard of *Gillette*, and its progeny, to make *D'Amico* applicable.

Second, the majority's opinion in the present matter, if carried to its logical end, would very likely result in unintended and inappropriate consequences. For example, assume a situation where the Department denies a taxpayer a refund of overpaid tax; this denial is based on a published and widely-disseminated revenue administrative bulletin setting forth the Department's interpretation of a tax statute. The matter is contested by the taxpayer with the court subsequently determining that the Department's stated interpretation is in error and establishing a new standard for the agency to apply. If, indeed, the Department is precluded from retrospectively *imposing* a tax because of a previously-published contrary agency interpretation, then it would arguably be precluded from retrospectively refunding an

⁷² *D'Amico*, 435 Mich at 558.

improperly-collected tax because of a previously-published contrary agency interpretation.⁷³

The constitutional guarantees of equal protection and uniformity of taxation contained in the Michigan Constitution would appear to dictate this result.⁷⁴

Finally, if the Court of Appeals majority opinion in this case is allowed to stand, the well-settled principle that judicial decisions must generally be applied retrospectively to all open matters, e.g., open tax years, will be subject to direct attack.

⁷³ It must be noted that, in addition to assessing SBT based on the retrospective application of the *Gillette* Due Process/Commerce Clause nexus standard, the Department also issued refunds to taxpayers based on the same application.

⁷⁴ See Const 1963, art 1, § 2, and art 9, §3.

CONCLUSION

Ultimately, the effect of the Court of Appeals majority opinion in the present matter is to give more weight to the prior interpretation or policy of a State agency than that afforded a subsequent judicial decision, no matter how egregiously application of the prior interpretation or policy affects the citizens of Michigan. The majority's opinion would arguably preclude a court from rectifying a situation where there exists a prior, yet erroneous, state agency interpretation or published policy. Further, this effect will likely result in unintended consequences, not the least of which might involve a violation of Michigan's Constitution.

RELIEF SOUGHT

The Department respectfully requests that this Honorable Court reverse the Court of Appeals majority opinion and adopt that of the dissent in this matter.

Respectfully submitted,

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